23 June 2009

Mr Bruce Porter
Acting Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
By E-mail: standard@aasb.gov.au

Dear Mr Porter

IASB/FASB Discussion Paper DP/2009/1 Project: Leases – Preliminary Views

Thank you for the opportunity to provide our comments on the IASB/FASB Discussion Paper DP/2009/1 *Leases Preliminary Views* (The Discussion Paper).

The Property Council is the peak body representing the interests of investors in Australia's $360billion commercial property investment industry. Approximately 2000 companies are members of the Property Council, ranging from Australia's largest institutions to private investors and developers covering the four quadrants of real estate investing - public, private, debt and equity.

The Property Council supports enhanced comparability of financial information between real estate companies worldwide.

The Property Council is strongly of the view that:

1) lessor accounting for the lease of real estate held for investment should be excluded from the scope of any new leasing model; and
2) accounting for the leasing of real estate investment assets as lessor is better addressed through amendment of IAS 40 *Investment Property* (IAS 40) to create a single robust and comprehensive accounting standard for this highly specialised industry.

We summarise below our overall views as to why amendment of IAS 40 will provide more meaningful financial reporting than scoping the leasing of real estate assets as lessor into a generic leasing standard. We have not, therefore, addressed many of the specific questions raised by the boards in the discussion paper as we do not consider them applicable to our position. However, we have included as Appendix A our specific responses to certain questions which we believe to be relevant to our industry.

We encourage the boards to consider lease accounting for lessors in conjunction with lease accounting from the perspective of lessees as we believe that this will result in the development of a more cohesive standard.

IAS 40 B6 comments that "the Board still believes that the characteristics of investment property differ sufficiently from the characteristics of owner-occupied property that there is a need for a separate Standard on investment property. In particular, the Board believes that information about the fair value of investment property, and about changes in its fair value, is highly relevant to users of financial statements."

We concur with the Board's view as expressed above and set out briefly below our views as to why we believe that the real estate industry is unique, followed by recommendations for amendment to IAS 40 such that IAS 40 is a single one-stop standard for the accounting for investment property, including revenue recognition thereon.

We believe that the real estate industry is unique as:

(a) real estate is fundamentally different from other leased assets – the right to benefit from demand to occupy the space above or below ground on a specified plot is unlimited by time;

(b) as lessor, the investor views an in-place lease as comprising only part of a constantly changing, indivisible property asset, the valuation of which is a highly developed concept and reflects factors more than the leases currently in place, for example demand and supply of assets, mix of tenants, building quality, building rating and refurbishment etc. Furthermore, due to the unique nature of many retail assets the residual value of a property is likely to be significant to its overall value;

(c) the creation of shareholder value in a real estate company is driven by exploitation of market forces driving cash flows and property values – typically these market forces comprise the demand and supply for the product in that location by occupiers and the demand and supply for investment property by other investors;

(d) real estate investment requires considerable active and intensive management – real estate investment companies create value by actively acquiring/developing, financing and managing property. The level of lessor participation in the overall management of the asset exceeds that typically found in equipment leases and the leasing of real estate is far more than a financing arrangement. Asset management includes tenant selection and lease negotiation to optimise the overall quality of and returns from the asset, property management (cleaning, provision of services, maintenance of common parts etc.), insurance etc;

(e) transfers of ownership of the rights to benefit from the returns from a property reflect a transfer of resources between investors who have different views of market rental growth, re-letting prospects, redevelopment prospects etc. compared with an alternative use of their funds. These returns derived from the property are market driven returns and comprise far more than simply the provision of finance to a lessee; and

(f) lessees of real estate are not simply looking for finance. In many cases the tenant is unable or unwilling to directly buy the asset. For example, for a retailer seeking premises in a shopping centre in which there are no individual units available for sale and in which the owner/manager has created an ambience of exclusivity and attractiveness which suits the tenants' market image; or a company seeking space in a CBD office building with direct access to transport links and facilities attractive to its workforce.

We are of the view that amendment to IAS 40 to provide an encompassing standard for the accounting of investment property rather than scoping lessors of real estate into a lease standard is appropriate for the following reasons:

(a) IAS 40 is well understood by the real estate industry, investors and analysts. The fair value convention under IAS 40 enables the user of the accounts to understand property performance based on the value enhancement/destruction caused by management actions and the changing market values for rents and valuation yields. IAS 40 could be further enhanced by incorporating into IAS 40 revenue recognition derived from real estate, including the accounting for lease incentives and initial direct costs, which would result in revenue recognition and the overall accounting for real estate investment property as lessor on a basis reflective of the key drivers of this industry;

(b) The valuation of the whole asset (rather than separate valuations for leases currently in place and a residual value) is of fundamental importance to the industry and is a significant factor in measuring the net asset value of companies that own and operate portfolios of investment property and thus for the pricing of the securities of such companies;

(c) Over a number of years market forces and industry co-operation has resulted in the emergence of key performance indicators and supplemental metrics which report the economics of real estate investment and which are consistent with the concept of the valuation of property as a whole indivisible asset; and

(d) The concept that the most appropriate way to reflect the income generation aspects of a lease of investment property is via an interest credit in the income statement is far removed from the reality of the business activities of a real estate investment company. We believe that the presentation of income as such would, in fact, be fundamentally misleading.

We have included in the Appendix our detailed observations on those questions that we consider relevant to our industry.

In conclusion, we do not concur with the scoping in of real estate into the lease standard as we believe that it:

- will result in financial reporting inconsistent with the focus of management and investors;

- will result in the loss of useful information to investors and users of financial statements and be potentially misleading; and

- will be unworkable from a practical perspective for real estate investment companies.

We would be pleased to meet with the Board or its staff to discuss any questions regarding our submission.

Yours Sincerely

R Fitz

Roberto Fitzgerald
Executive Director International & Capital Markets
Property Council of Australia

Email: rfitzgerald@propertyoz.com.au

Appendix A: Invitation to Comment

Question 1
The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

Refer to the main body of our letter

Question 2
Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

Yes – we believe that the inclusion of non-core assets and short-term leases will impose a significant administrative burden on many lessees and not provide incrementally valuable information. We consider that given their nature most non-core asset leases are likely to be short-term and, therefore, we would propose that leases of a term of less than or equal to 30 months be scoped out of the standard.

Question 3
Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

Not addressed

Question 4
The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognize:
(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)
(b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach?

If you support an alternative approach, please describe the approach and explain why you support it.

Not addressed

Question 5
The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognizes:

(a) a single right-of-use asset that includes rights acquired under options
(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

Do you support this proposed approach? If not, why?

A real estate investment and the lease contract with a particular tenant encompasses a whole range of rights and obligations from both the owner's and the tenant's perspective. This bundle of rights is tied up in the valuation of the asset and moving to an assessment of the individual rights and obligations would be both misleading and extremely complicated from the practical perspective.

Question 6 to Question 24

Not addressed

Question 25
Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

We do not consider that separate presentation of a lease asset (separate to the asset that is carried at fair value) will provide useful information to the users of the accounts.

Question 26
This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

As discussed in the main body of our letter our preference is that lessor accounting for real estate investment property is accounted for under an amended IAS 40. We do not consider that either of these proposed alternatives would result in the presentation of meaningful financial information to the users of the accounts.

Question 27
Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.

Not addressed.

Question 28
Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

Refer to the main body of our letter. We believe that real estate investment property accounted for under IAS 40 should be scoped out of any proposed new standard on lessor accounting. A separate standard for investment property that addresses the financial reporting for all elements of acquiring and operating investment properties, including the recognition of rental revenue from lease contracts of an investment property would result in the most decision useful information for users of the financial statements of real estate entities. We believe that this can be best achieved through the development of an amended IAS 40.

Question 29
Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.

Yes – if the accounting for real estate investment property is to be addressed by a single accounting standard being IAS 40 IAS 40 should be amended to address the accounting for lease incentives and for initial direct costs, in addition to consideration of the most appropriate basis for revenue recognition, i.e. straight-line or in accordance with the terms of the underlying lease arrangement (i.e. not subject to straight-lining). In our view the requirement to straight-line rental income does not reflect the commercial substance of the arrangement, does not provide incremental value to the user of the accounts, and is frequently adjusted by the analysts in their assessment of our real underlying earnings.